

STATE OF DELAWARE
OFFICE OF
AUDITOR OF ACCOUNTS

TOWN OF NEWPORT

THEFT OF FUNDS

SPECIAL INVESTIGATION

FIELDWORK END DATE: JULY 31, 2008

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State of Delaware
Office of Auditor of Accounts
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At a Glance

Working Hard to Protect YOUR Tax Dollars

Why We Did This Review

The Office of Auditor of Accounts (AOA) was contacted regarding a theft of funds at the Town of Newport (Town). It was requested that AOA look into the following:

- Embezzlement of cash deposits,
- Missing pension payments,
- Improper disbursements of Town funds, and
- Control weaknesses within the Town.

Background

Employees of the Town include administrative staff, maintenance staff, and law enforcement officers. Full time employees (those with benefits) currently total 14. As of February 1, 2007, law enforcement officers' retirement benefits were converted from a Town managed retirement account to the State pension system.

During spring 2008, the Town was informed that pension payments were not made. Upon looking into this matter, the Town identified additional areas of concern and requested the assistance of its accounting firm in investigating the matter. A theft of funds was identified and the person responsible, the Town Clerk, was terminated.

For further information on this release, please contact:

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TOWN OF NEWPORT- THEFT OF FUNDS

What We Found

- Over a 4-year period, the Town Clerk embezzled \$123,855 from the Town. She later repaid \$30,000 of this amount.
- The Town did not have appropriate internal controls to detect and deter inappropriate activity.
- Pension payments were made to the State pension plan for both administrative employees and officers. Errors in pension calculations were minimal and did not appear to be fraudulent.
- Over a 4-year period, \$613.37 in petty cash transactions were either improperly recorded or were not supported by adequate documentation.

What We Recommend

The Town should:

- Require adequate, detailed support for all transactions.
- Strengthen internal controls, including:
 - Implement a management review and approval process;
 - Maintain logs for licenses, permits, and checks;
 - Use pre-numbered forms;
 - Develop daily and monthly reports from the accounting system;
 - Utilize budget versus actual and prior year actual comparison reports;
 - Segregate duties;
 - Strengthen reconciliation controls;
 - Make daily deposits; and
 - Safeguard un-deposited funds.

Please read the complete report for a full list of findings/recommendations and to review the Town's response to our findings.

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AUDIT AUTHORITY

Title 29, Del. C. c. 29 authorizes the Auditor of Accounts to file written reports containing:

1. Whether all expenditures have been for the purpose authorized in the appropriations;
2. Whether all receipts have been accounted for and paid into the State Treasury as required by law;
3. All illegal and unbusinesslike practices;
4. Recommendations for greater simplicity, accuracy, efficiency, and economy; and
5. Such data, information, and recommendations as the Auditor of Accounts may deem advisable and necessary.

ALLEGATION AND BACKGROUND

ALLEGATION

The Office of Auditor of Accounts (AOA) was contacted regarding a theft of funds at the Town of Newport (the Town). It was requested that AOA look into the following:

- Embezzlement of cash deposits,
- Missing pension payments,
- Improper disbursements of Town funds, and
- Control weaknesses within the Town.

BACKGROUND

The Town is a .46 square mile town located in New Castle County, Delaware on the banks of the Christina River. For the year ending December 31, 2006, the Town reported \$1.3 million in revenue. Primary sources of revenue are property taxes, transfer taxes, business licenses, and other fees.

Employees of the Town include administrative staff, maintenance staff, and law enforcement officers. Full time employees (those with benefits) currently total 14. As of February 1, 2007, law enforcement officers' retirement benefits were converted from a Town managed retirement account to the State pension system.

During spring 2008, the Town was informed that pension payments were not made. Upon looking into this matter, the Town identified additional areas of concern and requested the assistance of its accounting firm in investigating the matter. A theft of funds was identified and the person responsible, the Town Clerk, was terminated.

OBJECTIVES, SCOPE, & METHODOLOGY

OBJECTIVES

The objectives of the investigation were:

- To determine the amount of funds embezzled from the Town;
- To determine that pension deductions were reasonable and properly remitted to the State pension plan; and
- To provide recommendations for strengthening internal controls within the Town.

SCOPE

The investigation included a review of pension withholdings and payments, disbursements, receipts, and payroll from March 1, 2003 through March 31, 2008 as well as a review of the Town's internal controls.

The investigation was performed in accordance with the President's Council on Integrity and Efficiency, *Quality Standards for Investigations*.

METHODOLOGY

The investigative approach included:

- Interview and inquiry.
- Inspection and confirmation of documentation.

CONCLUSIONS

Objective 1: To determine the amount of funds embezzled from the Town.

In reviewing deposits, the Town's accounting firm identified a theft of cash of \$123,615. Cash was received through the Town Office and through Court 42. The Town Clerk would take the cash received and alter deposit tickets to omit cash received by the Town. The thefts started in 2004 and continued until 2008, shortly before the Town Clerk was terminated. AOA tested the work of the accounting firm as well as performed additional testing of disbursements and pension withholdings. AOA's review identified an additional loss of \$156 attributable to personal use of a Town cell phone and \$84 in a payroll calculation error. The Town Clerk reimbursed the Town by depositing two personal checks in the Town's operating account totaling \$30,000. This resulted in a net loss of \$93,855.

It is possible that additional cash received by the Town Clerk for business licenses and permits was also stolen; however, the lack of controls related to cash receipts makes it impossible to estimate further thefts.

The theft of \$123,855 of Town funds is largely attributable to the lack of segregation of duties. The Town Clerk performed the cash collection and receipt processes, deposit preparation, check writing, payroll processing, recordkeeping, and bank reconciliations.

Objective 2: To determine that pension deductions were reasonable and properly remitted to the State pension plan.

AOA reviewed pension contributions to the State pension plan for administrative employees for the period of July 1, 2004 through June 30, 2008. AOA reviewed law enforcement officers' pension contributions from the date that the officers entered the State pension plan (February 1, 2007). AOA determined that pension payments were made to the State pension plan for both administrative employees and officers. Errors in pension calculations were minimal and did not appear to be fraudulent. The total net overpayment during the period of review was \$293.32. Details were provided to the Town's management to address.

Objective 3: To provide recommendations for strengthening internal controls within the Town.

Factors contributing to the fraud included (a) a lack of segregation of duties over cash receipts, disbursements, custody, accounting, and reconciliations; (b) non-compliance with the Town's cash handling procedures; and (c) lack of an integrated accounting system with management reporting capabilities. See page five of this report for recommendations.

FINDINGS AND RECOMMENDATIONS

Finding #1 –Internal Controls

Criteria

The Committee of Sponsoring Organizations of the Treadway Commission's report *Internal Control - Integrated Framework* identifies segregation of duties as a control activity where "Duties are divided, or segregated, among different people to reduce the risk of error or inappropriate actions . . .An appropriate segregation of duties often appears to present difficulties in smaller organizations, at least on the surface. Even (entities) that have only a few employees, however, can usually parcel out their responsibilities to achieve the necessary checks and balances." Segregation of duties is also identified as a monitoring activity. "Appropriate organizational structure and supervisory activities provide oversight of control functions and identification of deficiencies . . .Also, duties of individuals are divided so that different people serve as a check on each other. This is also a deterrent to employee fraud since it inhibits the ability of an individual to conceal his or her suspect activities."

Condition

The Town Clerk embezzled \$123,855 from the Town.

Cause

The Town did not have appropriate internal controls to detect and deter inappropriate activity. The theft was largely attributable to a lack of segregation of duties. The Town Clerk performed the cash collection and receipt processes, deposit preparation, check writing, payroll processing, recordkeeping, and bank reconciliations.

Effect

The lack of internal controls resulted in a loss of \$123,855, lost interest income on deposits, and delays in paying bills.

Recommendation

The Town should strengthen internal controls. The following should be considered in order to strengthen controls:

- Use pre-numbered forms (e.g. for business licenses, permits, receipts, etc.);
- Maintain a log for licenses, permits, and checks. This log should include support for voided transactions. Sequential number gaps should be investigated;
- Require timely recording of transactions into the Town's general ledger;
- Develop daily and monthly reports from the accounting system;
- Utilize the accounting system's capabilities and develop budget versus actual and prior year actual comparison reports;
- Maintain chain of custody. If, for example, deposits are transferred between the court clerk and town clerk, both employees should initial the deposit ticket;
- Segregate duties. e.g.: (a) an employee not directly involved in entering the transaction in the accounting system should perform monthly bank statement reconciliations; and (b) the person making deposits should not be the same person that enters the deposits into the accounting system;

FINDINGS AND RECOMMENDATIONS

- Review monthly reports for unusual trends;
- Hold employees accountable for noncompliance with policies and procedures;
- Make daily deposits;
- Safeguard un-deposited funds; and
- Limit access to Town credit cards and cell phones.

Auditee Response

The state auditor has recommended changes to strengthen the checks and balances, and the Town has implemented critical procedure changes regarding cash handling and check deposits. The full scope of the recommendations in this report is under review with intent to implement.

Prior to the theft of funds, the Town used pre-numbered business licenses and a pre-numbered cash receipts book. The Town did not use pre-numbered permit forms. Upon discovering the theft of funds, the Town immediately ceased accepting cash at the front desk; cash is only accepted at the Court window. The Town will begin using pre-numbered permit forms. The Town will maintain a log for licenses, permits, and checks, as recommended.

The Town acknowledges the current accounting system is limited in its reporting capabilities. The Town is reviewing alternative software packages. The Town notes that it transitioned to its current accounting system upon recommendation of the Town auditors, who urged the Town to cease using a previous software package.

The Town utilizes a budget vs. actual and prior year actual comparisons in preparing each fiscal budget. A three to five year comparison is reviewed for budget preparation. Prior year comparisons are used during the fiscal year for tracking key revenue and expense items, but not for each budget line item. The Town will strengthen this process, as recommended.

The Town hired an independent consulting accountant to review bank reconciliations during the audit transition, and has continued to use this third party for verification of bank reconciliations. Based on the auditor's recommendation, that role will be continued.

The Town currently keeps un-deposited funds in a two-drawer fire proof safe. The Town will explore an alternate safeguard.

The Town is reviewing signatories and access to credit accounts and cell phones. The Town does not have a debit or major credit card. It does maintain an office supply, building supply, and gasoline credit cards, and several house accounts for maintenance supplies.

Finding #2: Petty Cash Disbursements

Criteria

Good accounting policies require that transactions be supported by adequate documentation. This allows for review of transactions for allowability and support for each transaction of the Town.

FINDINGS AND RECOMMENDATIONS

Condition

AOA tested 100% of petty cash disbursements totaling \$8,774.47 during the period of April 2003 through March 2008 and determined that approximately 7% of the transactions were either unsupported or incorrectly recorded:

- 42 transactions totaling \$610.08 were missing receipts;
- 3 transactions were recorded incorrectly resulting in a variance of \$3.29.

Cause

Weak controls, including a lack of management approval and review, contributed to the lack of support and incorrectly recorded transactions.

Effect

Lack of adequate documentation raises questions about the validity of transactions and increases the possibility that unauthorized transactions may occur. Incorrect recording of information may cause records to be inaccurate or not useful.

Recommendation

The Town should:

- Require adequate, detailed support for all transactions.
- Implement a management approval and review process.

Response

The Town has changed its procedure to include a management initialing of all petty cash documentation.

DISTRIBUTION OF REPORT

Copies of this report have been distributed to the following public officials:

Executive

The Honorable Ruth Ann Minner, Governor, State of Delaware

Legislative

The Honorable Russell T. Larson, Controller General, Office of the Controller General

Other Elective Offices

The Honorable Joseph R. Biden III, Attorney General, Office of the Attorney General

Other

The Honorable Michael D. Spencer, Mayor, Town of Newport
Council of the Town of Newport, Delaware